



Memorandum

TO: City Council

FROM: Councilmember Sam Liccardo

SUBJECT: INCLUSIONARY ZONING

DATE: June 6, 2008

APPROVED:

June 9, 2008

RECOMMENDATION

1. Direct staff to actively pursue outreach to and communication with the development community as described on page 2 in the May 6, 2008 staff memorandum;
2. Return in Fall 2008 with an inclusionary housing proposal for Council approval that contains a range of alternatives, but which include the following elements at a minimum:
 - a. Expands inclusionary obligations beyond redevelopment areas;
 - b. Contains a "pressure-release valve" mechanism to adjust the inclusionary percentage downward during periods of below-average housing starts;
 - c. Protects projects in "the pipeline" from retroactive application of inclusionary obligations, with a range of alternatives on how to define the pipeline;
 - d. Allows for sufficient flexibility for developers in satisfying their inclusionary obligation, including but not limited to:
 - i. Allowing the developer to determine which units within a development will be designated below-market-rate,
 - ii. Allowing the construction of units off-site,
 - iii. Permitting the payment of fees or contribution of equivalent land in lieu of building the affordable unit,
 - iv. Credit-trading among developers, and/or
 - v. Any of the incentives and off-sets described on page 4 of the May 6, 2008 staff memorandum;
 - e. Contains reduced "in-lieu fees" or waived requirements for housing types having uniquely low profit margins;
 - f. Determines the percentage of inclusionary units to be required by this policy which will not exceed 20% for any area of the City; and

- g. Offers alternatives for “phasing” in any new requirements over time.
- 3. Since many of these issues require substantial discussion of nuanced details of policies, we further direct the City Manager and Redevelopment Agency Director to engage in a series of interviews with members of the development community concerning the costs, benefits, and impacts of variations of elements in the above recommendation and other relevant elements.
- 4. Provide a status report for City Council review on:
 - a. Existing City and Redevelopment policies and programs and how the affordable housing policy goals have been met over the years; and
 - b. The results of the Redevelopment 20% housing program, including the number of units achieved citywide and in project areas over the past two decades, and the number envisioned to be built citywide and in redevelopment areas in the foreseeable future.
 - c. Opportunities and alternatives to increase the supply of affordable housing in San José as identified by the development community.

BACKGROUND

The widespread fallout in financial markets, and the resulting plunge in new housing construction and sales, have generated great concern in recent months. In this context, any expansion of San José’s inclusionary policy must not further exacerbate the housing industry’s woes, but rather balance the needs of our home builders with the City’s affordable housing goals.

While the state of the current economy gives us reason for pause, the need for affordable housing remains a high priority. Even in this period of slow employment growth and falling home prices, the Santa Clara County continues to see an upward pressure on rents. San José’s rental vacancy rate continues to track around 4%, a number suggesting excessive demand for the existing capacity. That demand has driven up average rents 9.8% in the last year alone. According to RealFacts, which tracks data for large apartment complexes, the average rent in the San José metro area, \$1,600 per month, exceeded those of any other city in the state in April 2008, including San Francisco (\$1,596 per month). Safe, affordable housing remains a challenge for many families.

It’s also obvious why the lack of affordable housing constitutes the biggest obstacle to corporate expansion in the Valley, according to recent surveys of high tech CEO’s by Silicon Valley Leadership Group (SVLG).

The need for affordable housing will undoubtedly grow over time. The State’s Regional Housing Needs Allocation sets an expectation that San José create some 19,000 below-market homes over the next seven years to accommodate the need of its current and projected residents. Current policies remain vastly inadequate to meet that need.

The “Destination: Home” task force (formerly known as the “Blue Ribbon Commission on Homelessness”), led by Mayor Reed and Supervisor Don Gage, recently completed a comprehensive plan to end homelessness and to solve the affordable housing crisis. That plan laid out a number of

strategies that would require some \$25 million of investment over 5 years from multiple sources to create a sufficient network of permanent, extremely low-income housing to address Santa Clara County's homelessness crisis. Public resources remain vastly inadequate to meet that challenge.

In spite of the current spate of woes in the housing sector, it remains critical that we take the long view regarding our needs and resources in the coming years. Any policy that the Council crafts will have long-term effects that will far outlast the current housing slump. Other cities have similarly added inclusionary housing to their "toolbox" of options, including 170 jurisdictions in California alone.

Although San José could become America's largest city to expand our inclusionary policy beyond redevelopment areas, the concept is hardly novel here. For example, future expansion of inclusionary obligations was repeatedly suggested in the Five Year Housing Investment Plan that this Council adopted in 2007.

From repeated conversations with housing developers, property owners, and housing advocates, it has become apparent that the Council needs to ensure that whatever policy emerges from this process contains a few elements that will ensure that it will not adversely impact the housing industry:

- **Responsiveness to Market Conditions:** By creating a policy that automatically reduces the inclusionary requirements in hard times, we can ensure that we don't reduce housing starts at a time when we continue to need housing production. We can also reduce inclusionary obligations on those housing types that produce low profit margins or unusually high risks for developers.
- **Flexibility:** Allowing developers to pay "in lieu" fees both reduces the burden on housing developers and ensures that we're able to meet our housing goals. Other options for ensuring flexibility—such as credit-trading, design modifications, and the like—should be evaluated to ensure that the development community can continue to generate housing for our community.
- **Protect Reasonable Investment Expectations:** Those who have made decisions to buy and develop parcels in reliance on a fixed set of rules should not have the "rug pulled out" if inclusionary mandates affect land prices after they've applied for entitlements. By protecting those projects in the "pipeline," this policy will apply only prospectively to future developments, allowing the market to adjust to a different set of cost parameters for future investors and developers.

Although City Council should ensure that the policy includes these elements of flexibility, responsiveness to the market, and the like, the proposed policy must also address the demands for affordable housing in San José.

For that reason, the City Council should expand the current inclusionary policy beyond redevelopment areas, for several reasons. First, the 29% of the City's land that sits within redevelopment areas should not shoulder the responsibility for providing this housing; affordable housing works best where it has become integrated into the fabric of a larger mixed-income

community. Second, resources needed for the construction of extremely low-income housing dictate that the policy be as broadly cast as possible. A broad approach mitigates the need to apply obligations too heavily in any one area, or on any one type of housing. Finally, there exists an inherent inequity currently in San José where developers must shoulder an inclusionary burden on one side of a street—because they purchased a site in a redevelopment area—but can avoid the same obligation on the other side.

While the broad outline set forth in this recommendation sets the City Council and staff on a course to expand inclusionary requirements, it leaves many issues on the table for staff to formulate more precise recommendations, including:

- the percentage of below-market-rate units that will be required (up to 20%),
- the income allocation of those units (i.e., moderate, low income, very low income, extremely low income),
- the amount of in “lieu fees” required for each housing type,
- the phasing-in of inclusionary obligations, and the effective dates of those obligations,
- which off-sets or incentives accompany an inclusionary obligation,
- the threshold (i.e., the minimum number of units) at which inclusionary obligations would be required, and
- the precise definition of “the pipeline” for projects exempt from inclusionary requirements.

Those details will determine the success of any inclusionary policy, and we invite our City Council colleagues, the development industry, and the larger community to weigh in on each of these issues. Working collaboratively with our development community, we are confident that staff can draft an inclusionary policy for increasing the supply of affordable housing that is both effective and fair for City Council deliberation in the fall.